Revised ECB framework: Simpler or more complex?

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As part of easing capital account controls on the Indian economy, the Reserve Bank of India (RBI) has gradually been liberalizing regulations on external commercial borrowings (ECBs) from overseas lenders. A report of the Committee to Review the Framework of Access to Domestic and Overseas Capital Markets in February 2015 noted that: (a) ECBs are susceptible to currency fluctuation risk which in turn could affect "systemic stability"; (b) the regulatory framework for ECBs must be consistent and the approach must be predictable; (c) any regulations must be principle-based and not prescriptive; and (d) the ECB framework must be sector and participant neutral in that it should not discriminate among types and categories of borrowers and end-uses.

In view of the above, the report presented what must be described as radical recommendations: (i) removing all restrictions on borrowers, lenders, end-use, amount, maturity, and all-in cost ceilings; (ii) aligning the negative list in the ECB framework with that of the foreign direct investment policy; (iii) permitting all lenders from a Financial Action Task Force compliant jurisdiction; and (iv) requiring borrowers to demonstrate hedging prior to obtaining ECBs. Notably, the committee also recommended disallowing overseas branches of Indian banks from extending ECBs to Indian borrowers. While the government and the RBI reportedly disagreed with the recommendations, concerned that they would open the proverbial floodgates and risk economic instability, both appeared willing to engage in consultations to reform the ECB framework.

With this background, the RBI's release of the draft framework on ECBs on 23 September for public comments came as a pleasant surprise to market participants. Taking the form of a simplified list of "dos" and "don'ts" for raising ECBs, the draft framework proposed easing the prevailing requirements around eligible borrowers and end-uses, and also proposed expanding the scope of recognized lenders to include pension funds, sovereign wealth funds, insurance funds, and other "long term investors". The draft framework also emphasized shifting the currency risk to overseas lenders and further proposed introducing a "small negative list" for rupee denominated borrowings.

On 30 November (without any prior indication) the RBI issued the revised ECB framework, with a cover note saying that it reflects a "more liberal" approach with fewer restrictions on end-use and all-in-cost, and places the currency risk on the lender in case of rupee denominated ECBs. The revised framework retains the expanded scope of recognized lenders to include insurance companies and pension funds, and also retains the concept of a smaller negative list for end-uses for long-term ECBs and rupee denominated ECBs.

The revised framework divides ECBs into three tracks: track I for medium-term foreign currency denominated ECBs with a "minimum average maturity" (MAM) of three to five years; track II for long-term foreign currency denominated ECBs with a MAM of 10 years; and track III for rupee denominated ECBs with a MAM of three to five years. While the revised framework states that lending by overseas branches of Indian banks is subject to prudential guidelines, it also says that these branches are not eligible lenders for the purposes of tracks II and III.

While the procedural framework such as obtaining a loan registration number and periodic reporting to the RBI in the prescribed form remains unchanged, the revised framework significantly reduces the complexity of the previous ECB framework around eligible borrowers, recognized lenders, etc. The list of eligible borrowers under track II also includes real estate investment trusts and infrastructure investment trusts.

The revised framework further confirms that overseas long-term investors such as prudentially regulated financial entities, pension funds and insurance companies will be considered as eligible lenders, and also includes financial institutions in international financial services centres in India, thereby tying in with the government's initiative of establishing such centres in India. For rupee denominated ECBs, the revised framework does not prescribe any all-in-cost and instead states that this should be in line with market conditions.

The revised framework reflects the progressive movement of regulatory practice to a mix of principle and prescription-based regulation. However, due to some lacunae in the framework it is a non-starter for the moment. For instance, while the previous framework contained a detailed MS Excel-based methodology for determining "average maturity period", the revised framework does not prescribe how to determine MAM. Further, the revised framework notes that it will be effective from the date of publication of the relevant regulations under the Foreign Exchange Management Act, 1999, in the official gazette. As such regulations have not yet been published, the date of commencement of the revised framework is unknown.

Some think that the ECB framework could have done with another round of public discussions in view of the seminal changes it has introduced. Overall, while the issuance of the revised framework is a welcome initiative, its implementation could have been smoother and better planned.

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